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IN THE

Supreme Court of the United States

OCTOBER TERM, 1997

TOYS "R" US, INC. and TRU (HK) LIMITED,

Petitioners,

vs.

YUSUF AHMED ALGHANIM & SONS, W.L.L.,

Respondents.

ON PETITION FOR WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

PETITION FOR WRIT OF CERTIORARI

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QUESTIONS PRESENTED

1. Is clear legal error a basis for vacating an arbitration award?

2. What is the proper standard of judicial review of an arbitration award in the face of a claim that the award is clearly erroneous as a matter of law?

RULE 29.6 LISTING

Toys "R" Us, Inc. is not owned by any parent corporation. TRU (HK) Limited is a wholly-owned subsidiary of Toys "R" Us, Inc.

The following entities are partially owned by Toys "R" Us or its wholly-owned subsidiaries:

Toys "R" Us - Lifung Limited

Toys "R" Us - Lifung Taiwan Limited

Toys "R" Us (Malaysia) SDN. BHN.

Toys "R" Us - Japan, Ltd.

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PETITION FOR WRIT OF CERTIORARI

Toys "R" Us, Inc. and TRU (HK) Limited (collectively, "Toys 'R' Us") respectfully petition for a writ of certiorari to review the judgment of the United States Court of Appeals for the Second Circuit in this case.

Opinions Below

The opinion of the Court of Appeals is reported at 126 F.3d 15 (2d Cir. 1997). The opinions of the District Court and of

the arbitrator are unreported. Each of the opinions is reproduced in the appendix.[1]

Jurisdiction

The Court of Appeals entered its judgment on September 10, 1997. The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

Statutory and Contractual Provisions Involved

The pertinent provisions of the statutes and contracts involved are set forth in the appendix. (A-79-83.)

Statement of the Case

At a time when arbitration is becoming an increasingly utilized method of dispute resolution, the over $50 million award in this case — "reportedly the largest returned under American Arbitration Association jurisdiction in the past decade" (New York Law Journal, Dec. 19, 1996, at 4, col. 4) — presents an important question concerning the power of the courts to overturn an arbitration award where an arbitrator errs as a matter of law in interpreting a contract and awards damages in a clearly irrational amount. The decision of the court below is representative of recent decisions that effectively insulate arbitration awards from judicial review by vesting arbitrators with almost unchecked decision-making authority. If a clearly erroneous award cannot be reviewed by the courts for anything other than corruption or a blatant abuse of power by an arbitrator, then the number of matters submitted to arbitration almost certainly will be reduced. The result will be a decline in the utility of arbitration as a dispute resolution mechanism, and consequently an increase in the number of matters — especially complex business disputes — that will

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[1] All page references to the appendix are denoted in parentheses as "A-__."

have to be litigated in the already overburdened federal court system.

In this case a single arbitrator appointed by the American Arbitration Association ("AAA"), hearing a contract dispute between Toys "R" Us, Inc. ("Toys 'R' Us") and Yusuf Ahmed Alghanim & Sons, W.L.L. ("Alghanim"), which had a license to open Toys "R" Us stores in Kuwait and 13 other Middle East countries, erroneously determined that Toys "R" Us had no right to terminate the contract even though the contract explicitly granted both parties that right. The arbitrator also erroneously determined that Toys "R" Us had no right to insist that Alghanim toy stores conform to Toys "R" Us' usual standards, even though the contract explicitly granted Toys "R" Us th t right. The arbitrator then compounded his legal error by erroneously awarding Alghanim more than $50 million, based entirely on speculation about the profits Alghanim supposedly would have earned from operating Toys "R" Us stores in the ensuing 10 years, even though (a) in the 10 preceding years Alghanim's Toys "R" Us stores lost a total of $6.65 million, including losses virtually every year, and (b) Alghanim itself had asked for only $2 million to relinquish its rights.

The District Court refused to vacate the award because the arbitrator mentioned the contractual provisions at issue. (A-52.) The Court of Appeals stated it would not "overturn the arbitrator's award merely because we do not concur with the arbitrator's reading of the agreement" and held: "Interpretation of these contract terms is within the province of the arbitrator and will not be overruled simply because we disagree with that interpretation." (A-75.)

A. *The Underlying Agreement*

In November 1982, Toys "R" Us and Alghanim, a privately owned Kuwaiti conglomerate, entered into two agreements (collectively, the "agreement"). Toys "R" Us granted Alghanim a limited right, without the right to assign or grant sublicenses, to use Toys "R" Us trademarks and to open Toys "R" Us stores in Kuwait, as well as Bahrain, Egypt, Iran, Iraq,

Jordan, Lebanon, Oman, Qatar, Saudi Arabia, Sudan, Syria, United Arab Emirates and Yemen. (A-80.) Alghanim had to pay all the costs of store openings. (A-81.)

Paragraph 8.01 of the agreement gave each party the right to terminate on notice:

> This Agreement is effective as of November 16, 1982 and will remain in force for five (5) consecutive calendar years after the date of opening of the most recently opened [Alghanim] Toy Store in the territory; thereafter, the term of this Agreement will be automatically renewed for additional terms of two (2) consecutive calendar years each, unless either party shall give the other notice of its intention not to so renew not less than six (6) consecutive calendar months prior to the expiration of the initial or any renewed term then in effect. (A-82.)

Paragraph 2.07 of the agreement also obligated Alghanim to uphold the value of Toys "R" Us' trademarks, defined as "a unique and valuable asset of Toys "R" Us and "an inextricable element" of Toys "R" Us' "goodwill." Alghanim acknowledged that the use of Toys "R" Us trademarks "in conjunction with products of less than superior quality, or in association with less than the highest standards of advertising, promoting, selling and merchandising, would cause irreparable harm" to Toys "R" Us' goodwill and "incalculable injury" to Toys "R" Us trademarks. Accordingly, Alghanim agreed that:

> [Alghanim] will consult with [Toys "R" Us] in advance concerning the location, size, design, construction and layout of each [Alghanim] Toy Store and comply in all material respects with [Toys "R" Us'] usual standards concerning the same. (A-80-81.)

Paragraph 7.04 of the agreement obligated Toys "R" Us to direct to Alghanim any third party who made a bona fide offer to open a Toys "R" Us store in any of the 14 Middle East

countries specified in the agreement, and granted Alghanim a right of first refusal. If Alghanim declined such an offer or failed to open such a store within two years after receipt of such an offer, then the country for which the offer was made "would be deemed to have been deleted from the list of countries" covered by the agreement and Toys "R" Us would "be free thereafter to engage in the toy business in such country with or through such parties and in such manner as it chooses." (A-81-82.)

B. *Alghanim's Performance Under The Agreement*

From the signing of the agreement in 1982 until the commencement of arbitration in December 1993, Alghanim opened only four toy stores — all in Kuwait — and admitted that it lost $6.65 million. (A-105-08.) Alghanim made no effort to open any toy store in any of the 13 other countries set forth in the agreement, and after 1988 took no steps to open any new toy store in Kuwait. (A-108-09.)

It is undisputed that Alghanim lost money from this business each and every year except the year immediately following the Gulf war, when Kuwaitis restocked their homes — a total loss of $6.65 million. (A-105.)

C. *The Parties' Efforts to Terminate the Agreement*

After Kuwait's liberation from Iraq in 1991, both Alghanim and Toys "R" Us' concluded that the Alghanim toy business had not been a success for either party, and that the relationship between the parties needed to be changed. (A-100-04, 108.) Alghanim was "convinced that the way the business was done was wrong" (A-102), and was unwilling to commit further capital — a burden the agreement placed squarely on Alghanim — to a losing venture. (A-107, 110.) Accordingly, in September 1991 and February 1992, the parties met to try to restructure their agreement. When the parties could not agree on a restructuring, on July 20, 1992, Toys "R" Us tried to exercise its right to terminate the agreement. (A-94-95.) Alghanim responded on July 30, 1992, stating that its most recently opened toy store had opened on January 16, 1988

(not later in January 1988, as Toys "R" Us had believed), and that Toys "R" Us' July 20, 1992 non-renewal notice thus was four days late. (A-96-97.) According to Alghanim, Toys "R" Us' failure to provide notice of its election not to renew the parties' agreement by July 16, 1992 — six months before January 16, 1993, which was the fifth anniversary of the January 16, 1988 opening of Alghanim's most recently opened store — automatically extended the term of the agreement for an additional two years, until January 16, 1995. (*Id.*)

Toys "R" Us sent a second non-renewal notice on September 2, 1992. (A-98-99.) Even if Alghanim was correct in its interpretation that the agreement was automatically extended to January 16, 1995, Toys "R" Us' second notice unquestionably was sent more than six months before January 16, 1995, and thus was timely notice that the agreement would terminate not later than January 16, 1995. (A-82.) Toys "R" Us' September 2, 1992 non-renewal notice directed Alghanim not to open any new toy stores. (A-99.)

Alghanim took no steps to open a new toy store either before or after receiving Toys "R" Us' non-renewal notices, and in fact had not opened a new toy store since January 1988. Alghanim never claimed Toys "R" Us had no right to terminate the agreement. Instead, through the balance of 1992 and 1993, the parties tried, unsuccessfully, to negotiate a new arrangement or a termination of the agreement. In September 1993, Alghanim's Executive Vice President, Chief Operating Officer and the head of its toy business admitted that Alghanim was "no longer interested in being in the toy business" and that "we'll be happy to release the business right now," if Toys "R" Us "give[s] us $2 million for the losses we've incurred for trying to develop this business." (A-110.)

At the end of 1993, Toys "R" Us contracted with Al-Futtaim Sons Co., LLC ("Al-Futtaim") for the post-Alghanim rights to open Toys "R" Us stores in Bahrain, Kuwait, Oman, Qatar and the United Arab Emirates, and with ATA Development Co. ("ATA") for the post-Alghanim rights to open

Toys "R" Us stores in Saudi Arabia. Al-Futtaim originally agreed to pay Toys "R" Us $15 million for the rights in Bahrain, Kuwait, Oman, Qatar and the United Arab Emirates; ATA originally agreed to pay Toys "R" Us $15 million for the rights in Saudi Arabia. It is undisputed that Al-Futtaim reduced its payment to $11.325 million by holding back $3.675 million, the value it placed on the rights for Kuwait. It also is undisputed that ATA reduced its payment for Saudi Arabia to $7.5 million. Thus, Al-Futtaim and ATA actually paid Toys "R" Us a total of $18.825 million for the rights to Bahrain, Oman, Qatar, Saudi Arabia and the United Arab Emirates, and another $3.675 million for Kuwait.

D. *The Arbitration*

Despite paragraph 8.01 of the agreement, which expressly granted to both parties the right to terminate the agreement, the arbitrator erroneously found that Alghanim had the unilateral right to extend the "initial term" of the agreement indefinitely by opening new toy stores even if Toys "R" Us sent timely notice of non-renewal. The arbitrator further determined that Alghanim would have opened a new store by January 16, 1993, the last day of the "initial term", notwithstanding the undisputed evidence, specifically credited by the arbitrator, that it takes Toys "R" Us a minimum of eight to nine months to open a store which conforms to Toys "R" Us' usual standards, and that as of September 2, 1992, the date of Toys "R" Us' indisputably timely non-renewal notice, Alghanim had done nothing, indeed had not even selected a site, to prepare for such an opening. (A-108-09, 111.) Conceding that it would have been impossible for Alghanim to open a new store conforming to Toys "R" Us' usual standards by the January 16, 1993 termination date of the "initial term", the arbitrator found that Toys "R" Us had no right to enforce paragraph 2.07 of the agreement, opining that Toys "R" Us was using its right to insist on conforming stores "as a pretext to make it impossible for Alghanim to fulfill the condition for extension of the initial term." (A-29.)

The arbitrator then erroneously concluded that Alghanim would have pursued its toy business throughout the territory and earned profits over the ensuing 10 years with a net present value of $46.44 million, notwithstanding the facts that (a) Alghanim had only lost money on the business and all but abandoned it, and (b) there was no evidence that anyone valued Alghanim's rights at anywhere near that amount.

The arbitrator awarded Alghanim:

> (a) $9.41 million in "lost profits" for Kuwait, even though Alghanim had only lost money in Kuwait, and Al-Futtaim subsequently paid only $3.675 million for the right to open Toys "R" Us stores in Kuwait;
>
> (b) $27.58 million in "lost profits" for Bahrain, Oman, Qatar, Saudi Arabia and the United Arab Emirates, based on what ATA and Al-Futtaim had offered to Toys "R" Us, even though Alghanim never sought to open stores in any of those countries, Alghanim was contractually prohibited from assigning or sublicensing its rights in those countries, Alghanim had declined offers to open stores in those countries, thereby triggering the deletion provisions of the agreement, and ATA and Al-Futtaim actually paid only $18.825 million for the rights to open Toys "R" Us stores in those countries; and
>
> (c) $9.45 million in "lost profits" for Egypt and Jordan, even though Alghanim never sought to open any stores there, and no one placed any value on the right to open Toys "R" Us stores in those countries.

The arbitrator found that such damages were not speculative and distinguished the leading New York case prohibiting speculative damages, *Kenford Co. v. County of Erie*, 67 N.Y.2d 257, 502 N.Y.S.2d 131 (1986), on the ground that *Kenford* involved "damages based on future profits from concessions in a domed stadium that was never built" and at the time of the breach of contract in that case there was only one

other such facility in existence, whereas Toys "R" Us "has hundreds of toy stores worldwide." (A-46.) The arbitrator did not address the obvious fact that neither Toys "R" Us nor Alghanim — nor anyone else — had opened Toys "R" Us stores in the Middle East, other than Alghanim's unsuccessful stores in Kuwait.

In addition to $46.44 million in "lost profits" the arbitrator awarded Alghanim interest at 9 per cent per year beginning as of December 31, 1994. (A-47.)

E. *Proceedings Below*

The District Court's jurisdiction was invoked under 9 U.S.C. §§ 10-11 (the Federal Arbitration Act) and under 9 U.S.C. § 203 (the Convention for the Recognition and Enforcement of Foreign Arbitral Awards).

The District Court confirmed the award by Memorandum and Order dated December 13, 1996. (A-50-54.) On September 10, 1997, the Court of Appeals affirmed. (A-56-75.) The Court of Appeals cited its decision in *Florasynth, Inc. v. Pickholz*, 750 F.2d 171, 176 (2d Cir. 1984), which held that "the confirmation of an arbitration award is a summary proceeding that merely makes what is already a final arbitration award a judgment of the court," and its decision in *In re Marine Pollution Serv., Inc.*, 857 F.2d 91, 94 (2d Cir. 1988), which held that "the arbitrator need only explicate his reasoning under the contract in terms that offer even a barely colorable justification for the outcome reached..." (quoting *Andros Compania Maritima, S.A. v. Marc Rich & Co., A.G.*, 579 F.2d 691, 704 (2d Cir. 1978). Applying these principles, the Court of Appeals held that the arbitrator had not manifestly disregarded the law, finding that the arbitrator had "specifically addressed" *Kenford*, and noting that "mere error in the law or failure on the part of the arbitrator to understand or apply the law" does not constitute manifest disregard. (A-71-73, quoting *Fahnestock & Co. v. Waltman*, 935 F.2d 512, 516 (2d Cir. 1991)).

On October 3, 1997, the Court of Appeals stayed its mandate pending this petition. (A-76-78.)

Reasons for Granting the Writ

Recent years have witnessed a remarkable increase in reliance on arbitration as a means of dispute resolution. In 1996, the American Arbitration Association administered a record total of 70,516 cases, a 13% increase over 1995. (A-84.) An even more dramatic increase occurred regarding international matters, as the case flow into the AAA's international case administration over that same time period more than doubled. (A-88-89.)

This increasing reliance on arbitration parallels the continuing expansion of disputes deemed arbitrable, fueled by a series of Supreme Court cases reflecting faith in the competence of arbitral tribunals to resolve even the most complex matters. *See, e.g., Gilmer v. Interstate/Johnson Lane Corp.*, 500 U.S. 20 (1991) (ADEA claims); *Rodriguez de Quijas v. Shearson/American Express, Inc.*, 490 U.S. 477 (1989) (claims under the Securities Act of 1933); *Shearson/American Express, Inc. v. McMahon*, 482 U.S. 220 (1987) (RICO and Section 10(b) claims); *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614 (1985) (antitrust claims). This Court has expressly predicated its faith in arbitration on the premise that arbitration does not restrict parties' substantive rights, and that judicial review of awards, although necessarily limited, nevertheless is sufficient to ensure that arbitrators are following the law. *See, e.g., McMahon*, 482 U.S. at 232; *Mitsubishi Motors*, 473 U.S. at 628.

The reality, however, is that there is confusion and increasing uncertainty in the courts regarding the extent of substantive review of arbitration awards. The confusion stems from this Court's observation, more than 40 years ago, that an arbitrator's interpretation of the law, "in contrast to manifest disregard," is not subject to judicial review. *Wilko v. Swan*, 346 U.S. 427, 436-37 (1953). This *dicta* — in a case that was overruled (albeit on a different ground) in *Rodriguez de Quijas, supra* — has spawned an entire body of divergent

caselaw, with this Court indicating that "manifest disregard of the law" remains a basis for vacating arbitration awards in *First Options of Chicago, Inc. v. Kaplan*, 514 U.S. 938, 942 (1995), but with lower courts continuing to struggle with what this standard means. The only thing clear from the current state of the law is that judicial review is *not* sufficient to ensure that arbitration awards follow the law. *See generally* Stephen L. Hayford, *Law in Disarray: Judicial Standards for Vacatur of Commercial Arbitration Awards*, 30 Ga. L. Rev. 731, 774 (1996) ("To assert that the dictum from the Supreme Court's opinion in *Wilko v. Swan* has, after some forty years, left the federal circuit courts of appeals in a state of confusion...is an understatement."); Michael P. O'Mullan, *Seeking Consistency in Judicial Review of Securities Arbitration: An Analysis of the Manifest Disregard of the Law Standard*, 64 Fordham L. Rev. 1121, 1124 (1995) ("[T]he federal courts of appeals are sharply divided over when review of an arbitration award is appropriate....").

A. This Court Should Grant Certiorari To Resolve A Split In The Circuits Over The Standard For Vacating An Award.

The circuit courts are seriously conflicted as to when an award is sufficiently baseless to warrant vacatur. *First*, although some circuits, following the *Wilko* dicta, allow the vacating of an award for "manifest disregard" of the law, other circuits have rejected the *Wilko* dicta and held that the statutory grounds for vacatur set forth in the Federal Arbitration Act, 9 U.S.C. § 10 (A-79) provide the sole bases for refusing enforcement of an arbitration award. The Seventh Circuit, for example, has rejected the concept of "manifest disregard" as "superfluous and confusing," indicating that it simply parallels the statutory ground of whether "the arbitrators exceeded their powers." *Baravati v. Josephthal, Lyon & Ross, Inc.*, 28 F.3d 704, 706 (7th Cir. 1994). The Fourth and Fifth Circuits have likewise indicated that the only grounds for vacating an arbitration award are those expressly provided by statute. *Remmey v. PaineWebber, Inc.*, 32 F.3d 143 (4th Cir. 1994),

cert. denied, 513 U.S. 1112 (1995); *Forsythe Int'l, S.A. v. Gibbs Oil Co.*, 915 F.2d 1017, 1020 (5th Cir. 1990).

Second, other circuits have recognized non-statutory bases other than "manifest disregard" of the law for the vacation of arbitral awards. The Ninth Circuit, for example, has espoused "complete irrationality" in addition to "manifest disregard" as a basis for vacatur. *Galaxie Boat Ctr., Inc. v. ITT Commercial Fin. Corp.*, No. 96-55175, 1997 U.S. App. LEXIS 14934 (9th Cir. June 19, 1997). The Eleventh Circuit has added an additional layer of complexity, rejecting the "manifest disregard" standard, but analyzing whether the award is "arbitrary or capricious" — but only if an opinion accompanies the award. *Brown v. Rauscher Pierce Refsnes, Inc.*, 994 F.2d 775, 779 (11th Cir. 1993). These varying formulations give little guidance as to when an award is substantively infirm and should not be enforced.

Third, there is confusion as to what the "manifest disregard" standard means. Some courts, including the Second Circuit, interpret the word "disregard" quite narrowly, requiring demonstrable evidence that the arbitrator "appreciates the existence of a clearly governing legal principle but decides to ignore or pay no attention to it." *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Bobker*, 808 F.2d 930, 933 (2d Cir. 1986). The term "manifest" is ascribed an equally narrow meaning, held to require that the error be "obvious and capable of being readily and instantly perceived by the average person qualified to serve as an arbitrator." *Id.* Nowhere, however, has there been any indication of what qualifications the "average" arbitrator should possess, or what distinguishes an ordinary error from an "instantly" perceptible one.

The ultimate effect of the Second Circuit's approach — requiring express acknowledgment and rejection of a governing principle — is to require a showing of affirmative, deliberate misconduct by the arbitrator before a court will vacate the award, even if the award itself is demonstrably wrong. For example, the court in *DiRussa v. Dean Witter Reynolds, Inc.*

concluded that an arbitrator did not "manifestly disregard" the mandatory attorneys' fee provision of the ADEA, despite the fact that the arbitrator rejected the request for attorneys' fees, because the attorneys had not expressly informed the arbitrator that attorneys' fees were mandatory, nor had the arbitrator explained his reasons for not granting fees. 121 F.3d 818, 1997 U.S. App. LEXIS 20505 at *10-11 (2d Cir. 1997). A petition for a writ of certiorari was filed in *DiRussa* on November 3, 1997, raising the question whether courts may modify or vacate an arbitration award in the face of a claim that the award was clearly erroneous as a matter of law. Likewise, the Court in *Exxon Shipping Co. v. Exxon Seaman's Union* indicated that an arbitrator's decision "need be neither wise nor internally consistent." 73 F.3d 1287, 1297 (3d Cir.), *cert. denied,* 116 S. Ct. 2515 (1996). This focus on the arbitrator's subjective state of mind is misplaced: if an award is plainly wrong, the arbitrator's subjective intent is irrelevant. Furthermore, as one commentator noted, manifest disregard under this test is "nearly impossible to prove because, even in the rare case where an arbitrator deliberately ignores controlling law, the arbitrator will not announce his misconduct." Kenneth R. Davis, *When Ignorance of the Law is No Excuse: Judicial Review of Arbitration Awards*, 45 Buff. L. Rev. 49, 94 (1997).

In contrast, the First Circuit has indicated that an arbitration award may be vacated upon a showing that the award was:

> (1) unfounded in reason and fact; (2) based on reasoning so palpably faulty that no judge, or group of judges, ever could conceivably have made such a ruling; or (3) mistakenly based on a crucial assumption that is concededly a non-fact.

Advest, Inc. v. McCarthy, 914 F.2d 6, 8-9 (1st Cir. 1990). Under this more liberal standard, the arbitrator's subjective state of mind is irrelevant; the test is an objective evaluation of whether the award itself is fundamentally flawed.

B. This Court Should Grant Certiorari To Resolve Whether A Clear Legal Or Factual Error Can Serve As The Basis For Vacating An Arbitral Award.

There is also confusion among the lower courts on the basic question of whether an arbitrator's misreading of a contract is reviewable by a court. For example, the Fifth Circuit has deemed it an "excess of power" under 9 U.S.C. § 10 if an arbitrator makes an "unambiguous and undisputed mistake of fact and the record demonstrates strong reliance on that mistake," *Valentine Sugars, Inc. v. Donau Corp.*, 981 F.2d 210, 214 (5th Cir. 1993), whereas the Second Circuit has interpreted the "excess of powers" provision much more narrowly, confining it solely to the question of whether an issue was actually presented to the arbitrator, not whether the arbitrator correctly resolved that issue. *DiRussa v. Dean Witter Reynolds Inc.*, *supra*, 1997 U.S. App. LEXIS at *17. The Sixth Circuit has added its own twist to the statutory grounds, expanding the meaning of "excess of powers" to encompass situations in which the award fails to "draw its essence" from the parties' contract. *Federated Dep't Stores, Inc. v. J.V.B. Indus., Inc.*, 894 F.2d 862, 866 (6th Cir. 1990). There is thus confusion among the circuits on the basic question of the judiciary's authority to review arbitral awards for legal or factual error. Given this Court's repeated endorsement of arbitration for dispute resolutions, it is incumbent upon this Court to resolve that uncertainty.

Indeed, the confusion over the degree — if any — to which federal courts can vacate arbitral awards for legal or factual error has encouraged unreasoned arbitral decisionmaking. This is reflected in the directive of the American Arbitration Association that its arbitrators should give as little insight as possible into the reasons for their awards:

> [o]ne reason for brevity is that written opinions might open avenues for attack on the award by the losing party....a carelessly expressed thought in a written opinion could afford an opportunity to delay

> enforcement of the award. The obligations of the parties are better fulfilled when the award leaves no room for attack. (A-92.)

The AAA further advises its arbitrators not to explain their award later, in part because "[a] party might try to impeach the award by getting the arbitrator to divulge his or her reasoning or thought processes." (*Id.*)

Somewhat perversely, the principles governing judicial review of arbitral awards in some circuits encourage arbitrators not to explain their awards. Lower courts have declined to overturn awards on the ground that arbitrators have not explained their reasoning. For example, the Second Circuit in *DiRussa v. Dean Witter Reynolds* upheld an award which, on its face, contravened a federal statute mandating the award of attorneys' fees, in large part because the arbitrator had not expressly set forth the reasons for rejecting the request for such fees. 1997 U.S. App. LEXIS 20505 at *10-11. The Eighth Circuit in *Stroh Container v. Delphi Industries* likewise found that it could not deem an award to be in "manifest disregard of the law" because the arbitrators' decision neither indicated what law was applied nor what reasoning or analysis were used. 783 F.2d 743, 751 (8th Cir. 1986). The court in *Stroh* indicated its view that arbitration is an "inferior system of justice," in part because arbitration is structured without "accountability of judgment and rules of law." 783 F.2d at 751 n.12. The Eleventh Circuit questioned whether it should bother to adopt the "manifest disregard" standard, "since the standard would likely never be met when the arbitrator provides no reasons for its award (which is typically the case)," *Raiford v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 903 F.2d 1410, 1413 (11th Cir. 1990), and later indicated that it would not consider *any* non-statutory bases for vacatur of lump-sum awards unaccompanied by written opinions. *Brown v. Rauscher Pierce Refsnes, Inc.*, 994 F.2d at 779.

In short, certiorari should be granted to address the need of federal courts for guidance in what has become an increasingly important — yet increasingly lawless — area of law.

Although some of the distinctions drawn by the lower courts may be semantic, the critical question which this case presents is whether there is to be any meaningful judicial review of arbitration awards in the absence of evidence of corruption or misconduct. If the answer is no — that so long as arbitrators mention the relevant contractual provisions and case law and appear to be trying to apply them, or say nothing at all, the award stands — the lower courts and the business world should be so advised so that they can make intelligent decisions about whether to submit controversies to arbitration knowing there is no meaningful judicial review. If, on the other hand, the concept of "manifest disregard" means that courts may overturn a clearly erroneous arbitration award, the lower courts and the commercial world should also be so advised. *See generally* Brad A. Galbraith, *Vacatur of Commercial Arbitration Awards in Federal Court: Contemplating the Use and Utility of the "Manifest Disregard" of the Law Standard*, 27 Ind. L. Rev. 241, 261-63 (1993) (noting that circuit courts are "hopelessly confused and inconsistent" and that "parties must know up-front what grounds are available for vacating arbitration awards in order for the commercial arbitration process to serve its intended purpose.").

C. The Award In This Case Would Be Vacated If Subjected To Meaningful Judicial Review.

The award in this case erroneously reorganizes the rights of the parties in a manner for which the parties certainly never bargained. The parties bargained for a contract which either party could terminate upon timely notice, as reflected in paragraph 8.01 of the agreement. Despite having acknowledged the existence of this unambiguous contractual provision, the arbitrator nevertheless ruled that if Alghanim were to open a new store

> at any time up to the last day of the initial period, the initial period would be extended for an additional five year period from the opening of that new store, *regardless even of timely notice of non-renewal.* (A-6-7) (emphasis added).

Using this clearly erroneous reading of the contract, the arbitrator proceeded to determine that Alghanim would in fact have been able to extend the agreement by opening a new store by January 16, 1993, the last day of the initial period. Faced with the absence of any evidence that Alghanim could have timely opened a store conforming to Toys "R" Us' usual standards, the arbitrator mistakenly decided that Alghanim need not be held to this part of its bargain, asserting that Toys "R" Us had invoked paragraph 2.07 of the agreement as a "mere pretext to make it *impossible* for [Alghanim] to fulfill the condition for extension of the initial term." (A-29.) (emphasis added). In reaching this decision, the arbitrator incorrectly opined that, notwithstanding the express terms of the contract, Toys "R" Us really did not care whether or not stores bearing its name conformed to its usual standards because Toys "R" Us "was being compensated under the [agreement] by royalties and commissions, payable whether or not [Alghanim's] toy stores were profitable." (*Id.*)

Through these erroneous revisions of the contract, the arbitrator granted to Alghanim, at Toys "R" Us' expense, rights which Alghanim had not obtained at the bargaining table. If the "initial term" of the contract ended on January 16, 1993, it is undisputed that Alghanim suffered no damages. The arbitrator wrongly found, in contrast, that Alghanim could and did extend the contract indefinitely, and then wrongly proceeded to issue a "lost profits" award exceeding $50 million to a party which had not had any profits or reasonable expectation of any.

A clearly erroneous standard of review would have required vacating the arbitrator's award. The District Court upheld the award simply by pointing to pages in the arbitrator's opinion which addressed the contractual provisions which Toys "R" Us contended had been ignored. (A-52). The Court of Appeals, noting that it could not "overturn the arbitrator's award merely because we do not concur with the arbitrator's reading of the agreement," adopted the District Court's reasons for upholding the arbitrator's treatment of the contract. (A-75). But the pages of the arbitrator's opinion cited by the

District Court and the Court of Appeals clearly demonstrate that the arbitrator refused to permit Toys "R" Us to enforce paragraphs 2.07 or 8.01 of the agreement according to their terms. (A-6-7, 29, 52). The arbitrator was not "interpreting" the agreement: he — whether intentionally or unintentionally — refused to enforce it. Meaningful judicial review would have corrected this fundamental conflict between the express terms of the contract and the arbitrator's finding.

Here, however, under the "manifest disregard" standard, neither court below reached the question of whether the arbitrator's reading of the contract was correct — or even logical.

Moreover, neither court addressed the irrationality of awarding $50 million in "lost profits" for stores which had never opened (or even been contemplated) in regions in which neither Alghanim nor Toys "R" Us had ever demonstrated any business success. Alghanim acknowledged that over a ten year period, it lost a total of $6.65 million running Toys "R" Us stores in Kuwait, including losses virtually every year it operated. Alghanim also acknowledged that over the same ten year period, Alghanim *never* expanded outside Kuwait, despite having the right to do so, and despite receiving dozens of referrals from Toys "R" Us of inquiries from third parties interested in opening Toys "R" Us stores in Middle East countries covered by the parties' agreement, including such obviously well-financed sources as the Saudi royal family. Nowhere did Alghanim — or the arbitrator — ever explain how Alghanim possibly could have converted an over $6 million loss by an operation that for 10 years was unwilling or unable to expand its business beyond Kuwait into an enterprise spanning the Middle East and earning a more than $50 million profit. An award of more than $50 million in lost profits for an alleged breach of contract to a business that only lost money before the contract allegedly was breached plainly is irrational.

Furthermore, Alghanim itself asked for only $2 million to relinquish its rights under its contract with Toys "R" Us in September 1993, a full year *after* Toys "R" Us' alleged

breach of contract. (A-109-10.) While the arbitrator adopted Alghanim's depiction of this fact simply as a "claim" by Toys "R" Us concerning a conversation between a Toys "R" Us official and an Alghanim official, the record belies Alghanim's contention. Keith Van Beek of Toys "R" Us testified concerning what he was told by Amin Kadrie of Alghanim. Mr. Kadrie, who attended most of the arbitration proceedings, including the sessions at which Mr. Van Beek testified, did not contradict Mr. Van Beek's testimony under oath. Mr. Kadrie's silence confirms that exactly what Mr. Van Beek testified to did in fact happen: Mr. Kadrie valued his own business at $2 million. The arbitrator's award of *25 times* that amount is completely unsupportable.

Rather than address the substance of these undisputed facts, however, both courts below noted that the arbitrator had "specifically" mentioned *Kenford*, the leading New York case barring the award of speculative lost profits, and therefore concluded that there had been no manifest disregard of New York law. Had there been meaningful, substantive evaluation of the award, the courts would have had to address the fact that as a matter of law, the arbitrator's distinction of *Kenford* was just plain wrong. The damages award in this case was entirely speculative and completely irrational because Alghanim produced no evidence that even begins to demonstrate how Alghanim could have transformed a ten-year operating history which resulted in $6.65 million in losses into a business that could generate $46.44 million in profits.

Certiorari should be granted to clarify whether the federal courts have the authority to remedy such unwarranted reorganization of the parties' contractual rights. Absent such clarification, parties will enter arbitration agreements at their peril, and the courts will continue to issue confused and contradictory decisions as to the scope of judicial review of arbitral awards.

Conclusion

For the foregoing reasons, a writ of certiorari should issue to the United States Court of Appeals for the Second Circuit.

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